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DEPARTMENT PASS TREASURY AND FRB

E.O. 11652:N/A

TAGS: EFIN, UK

SUBJECT: APPLICATIONS BY BRITISH COMPANIES FOR UK GOVERNMENT FINANCIAL ASSISTANCE

REF: (A) LONDON 1979; (B) LONDON 2029

BEGIN SUMMARY: THE NUMBER OF BRITISH FIRMS SEEKING FINANCIAL ASSISTANCE FROM THE UK GOVERNMENT HAS INCREASED IN QUANTITY AND QUALITY IN THE PAST 6 MONTHS. PATTERNS ARE BEGINNING TO EMERGE OF CORPORATE FINANCIAL PROBLEMS DUE TO RECESSION AND A SQUEEZE ON COMPANY CASH/FLOW, BUT ALSO IN SOME CASES TO FINANCIAL MISMANAGEMENT. AT THIS POINT, IT DOES NOT APPEAR THAT THE FINANCIAL SQUEEZE PER SE IS THE SOLE CULPRIT. END SUMMARY

1. THE NUMBER OF COMPANIES APPLYING FOR FINANCIAL ASSISTANCE FROM THE UK GOVERNMENT HAS INCREASED SIGNIFICANTLY IN THE PAST 6 MONTHS. BUT EVEN MORE WORRISOME IS THE SIZE

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OF THE COMPANIES NOW REQUESTING ASSISTANCE. THESE NOW

TEND TO BE THE LARGER, NORMALLY MORE Viable COMPANIES SUCH AS BRITISH LEYLAND, FERRANTI, ALFRED HERBERT, ETC. THESE ARE THE COMPANIES THAT WOULD ORDINARILY BE ASSUMED TO HAVE THE RESOURCES AND THE KNOW-HOW TO WEATHER THE ECONOMIC DOWNTURN.

2. THE PRESENT INDUSTRIAL LEGISLATION, THE 1972 INDUSTRY ACT, HAS TWO PROVISIONS FOR GOVERNMENT FINANCIAL ASSISTANCE IN INDUSTRY. SECTION 7 DEALS WITH THE DEVELOPMENT REGIONS AND ALLOWS GOVERNMENT FINANCIAL ASSISTANCE TO COMPANIES WANTING NEW OR EXPANDED PRODUCTION FACILITIES OR FOR "MAINTENANCE OF EMPLOYMENT" IN THOSE REGIONS. SECTION 8 OF THE 1972 ACT ALLOWS FINANCIAL ASSISTANCE TO COMPANIES WHICH ARE IN FINANCIAL DIFFICULTY AND WHOSE DEMISE IS BELIEVED INJURIOUS TO UK NATIONAL INTERESTS, AND WHICH CAN-NOT FIND SUCH ASSISTANCE FROM ANY OTHER SOURCE.

3. SINCE MID-SUMMER 1974, THE NUMBER OF APPLICANTS UNDER SECTION 7 HAS DECLINED. THIS SEEMS NATURAL AS AN ECONOMIC DOWNTURN WOULD REDUCE INVESTMENT INTENTIONS, THUS REDUCE PLANS FOR NEW OR EXPANDED FACILITIES IN DEVELOPMENT REGIONS. WHILE THE OVERALL NUMBER OF APPLICANTS HAS DECREASED, THE NUMBER AMONG THEM APPLYING FOR "MAINTENANCE OF EMPLOYMENT" REASONS HAS INCREASED, AND THE SIZE OF THE FIRMS APPLYING FOR SUCH ASSISTANCE HAS INCREASED.

4. THE NUMBER OF APPLICANTS UNDER SECTION 8 HAS ZOOMED, AT LEAST IN PERCENTAGE TERMS, THOUGH TOTAL FIGURES ON APPLICATIONS ARE NOT AVAILABLE. DEPT OF INDUSTRY SOURCES (PROTECT) SAY THAT IN JUNE 1974, THE DEPT WAS CONSIDERING ABOUT 10 SECTION 8 CASES; NOW THEY HAVE 20 UNDER REVIEW. BUT THIS DOES NOT COUNT THE MANY BUSINESSES WHO HAVE BEEN "REJECTED OUT OF HAND" AS NOT EVEN CLOSELY FULFILLING THE CRITERIA OF SECTION 8. THESE APPLICATIONS DO NOT EVEN GET INTO THE STATISTICS.

5. WHILE THE ACTUAL NUMBER OF CASES UNDER CONSIDERATION UNDER EITHER SECTION (EVEN AFTER AN INCREASE OF 100 PER-CENT IN SECTION 8) DOES NOT SEEM THAT STARTLING, GIVEN A SEVERE ECONOMIC DOWNTURN, IT IS THE SIZE (I.E. QUALITY) OF LIMITED OFFICIAL USE

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THE RECENT APPLICANTS THAT TENDS TO CONCERN THE INDUSTRY DEPT. OTHER THAN THOSE MENTIONED ABOVE (WHICH ARE WELL-PUBLICIZED) THERE HAVE BEEN APPLICATIONS BY OTHER SUB-STANTIAL FIRMS (A LARGE TRUCK PRODUCER, A FORK-LIFT MANUFACTURER, ETC.--NAMES WERE NOT MENTIONED) FOR WHOM THE SUBSTANTIAL REDUCTION IN DEMAND SHOULD NOT HAVE PROVEN DIFFICULT OR FATAL. MANY OF THE SMALL, "REJECTED OUT OF HAND" FIRMS ARE CONNECTED WITH CONSTRUCTION WHICH SUFFERED

A DISASTROUS 1974.

6. THE PATTERN AMONG ALMOST ALL APPLICANTS FOR ASSISTANCE (CONSTRUCTION-CONNECTED FIRMS EXCEPTED) STEMS FROM A MISJUDGMENT OF THE MARKET. SINCE JUNE, DEMAND HAS WEAKENED SUBSTANTIALLY, ORDERS HAVE FALLEN OFF; THESE FIRMS HAVE BEEN CAUGHT WITH LARGE INVENTORIES TO FINANCE AND HAVE EXPERIENCED A FINANCIAL SQUEEZE. IN SOME CASES, THE PRO-

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BLEM HAS BEEN EXACERBATED BY POOR FINANCIAL PRACTICES (INCLUDING PRICING PRACTICES), ACCORDING TO INDUSTRY DEPT SOURCES. BRITISH LEYLAND IS ONE EXAMPLE OF THIS. IN OTHER CASES IT IS SIMPLY A QUESTION OF A FINANCIAL SQUEEZE AT A BAD TIME. SOME HAD INCREASED DEBT TO GET OVER THE 3-DAY WORK PERIOD OF THE FIRST QUARTER OF 1974 AND NEVER ADEQUATELY REDUCED THAT DEBT BEFORE THE ORDER FALL-OFF BECAME SERIOUS. IN SOME CASES, COMPANIES HAD NOT REVIEWED PRICING POLICIES ADEQUATELY. (ONE CASE WAS CITED OF A

FIRM WHOSE EXPORT BUSINESS WAS BOOMING BUT WHOSE COSTS HAD SOARED, WITHOUT PRICE INCREASES, TO THE POINT THAT GOODS WERE ACTUALLY BEING SOLD BELOW MARGINAL COST. THE FIRM HAD NOT REVIEWED ITS PRICE/COST STRUCTURE AND HAD GONE MERRILY AHEAD ASSUMING MORE SALES WERE BENEFICIAL.) FAILURE TO REVIEW PRICING CANNOT BE BLAMED ON THE PRICE CODE AS PRICES WILL BE ALLOWED TO RISE IF COSTS WARRANT A RISE.

7. MOST OF THE APPLICANTS HAVE EXHAUSTED EVERY AVENUE
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PRIOR TO APPEARING AT THE GOVERNMENT'S DOOR FOR HELP. WHEN THEY DO COME TO THE DEPT OF INDUSTRY, THEY ARE OFTEN IN VERY BAD SHAPE, TOTALLY "BORROWED UP," WITH "GEARING WAY OUT OF LINE," AND VERY DIFFICULT TO SAVE. ACCORDING TO INDUSTRY DEPT SOURCES, IT WAS DIFFICULT "TO GIVE 50 MILLION POUNDS TO BRITISH LEYLAND," AS THEY WERE IN SUCH BAD FINANCIAL SHAPE. IN MANY CASES AN EQUITY INJECTION IS THE ONLY PRACTICABLE WAY TO HELP THE FIRM.

8. IF THE EQUITY MARKETS WERE FUNCTIONING PROPERLY HERE (THEY ARE DORMANT--EXCEPT FOR A RISE IN THE PAST 3 WEEKS) SOME OF THESE COMPANIES MIGHT HAVE NOT BEEN FORCED TO REQUEST ASSISTANCE. WITHOUT A FUNCTIONING EQUITY MARKET THEY ARE DRIVEN TO THE GOVERNMENT WHEN THEY REACH THE END OF THEIR BANK CREDIT LINES.

9. THE DEPT OF INDUSTRY HAS BEEN USING A GUARANTEE PROGRAM TO ASSIST THESE INDUSTRIES, UNDER WHICH THEY GUARANTEE BANK OR SUPPLIER CREDIT UP TO A CERTAIN AMOUNT. THIS PRACTICE HAS NOT PROVED EFFICACIOUS, HOWEVER, AS THE INDUSTRY DEPT CLAIMS IT LOSES ALL CONTROL OF COMPANY PRACTICES (OR RATHER NEVER GAINS ANY CONTROL), AND INSTEAD OF RELAXING, SUPPLIERS LINE UP FOR MORE-RAPID-THAN-USUAL PAYMENT, KNOWING THERE IS A GOVERNMENT GUARANTEE.

10. OUR INDUSTRY DEPT SOURCES SEE SOME CONFLICT WITH THE NATIONAL ENTERPRISE BOARD (NEB), PROPOSED IN THE NEW INDUSTRY LEGISLATION, IN THE AREA OF GOVERNMENT ASSISTANCE TO INDUSTRY. THE NEB WILL SUPPOSEDLY BE THE ONLY AGENCY ALLOWED TO TAKE EQUITY IN COMPANIES, YET ITS MANDATE IN THE PROSPECTIVE LEGISLATION IS TOWARDS "PROFITABLE" COMPANIES, THOUGH MAINTENANCE OF EMPLOYMENT IS ALSO ONE OF ITS OBJECTIVES. BUT FOR MANY OF THE COMPANIES REQUESTING FINANCIAL HELP, THERE IS NO RECOURSE BUT EQUITY FINANCING. HOW THIS WILL BE RESOLVED BETWEEN THE DEPT OF INDUSTRY AND THE NEB REMAINS TO BE SEEN.

11. COMMENT. WHILE A PATTERN OF A CORPORATE FINANCIAL

SQUEEZE IS APPARENT IN THE NUMBERS AND SIZE OF BRITISH FIRMS LINING UP FOR GOVERNMENT FINANCIAL AID, THE CAUSES ARE NOT UNIFORM. SOME CASES RESULT FROM POOR FINANCIAL
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POLICIES, SOME FROM POOR PRICING POLICIES, SOME FROM MIS-JUDGING MARKETS AND POOR PRODUCTION AND INVENTORY CONTROL. THUS THE GROWING QUANTITY AND SIZE OF NEEDY FIRMS MAY NOT INDICATE A CORPORATE SECTOR FINANCIAL SQUEEZE PER SE (I.E. ONE THAT FORCES COMPANIES WITH GOOD FINANCIAL MANAGEMENT AND PRICING POLICIES TO SEEK ASSISTANCE). THERE IS ALSO EVIDENCE OF INADEQUATE INTERNAL CONTROL.

12. A DEPRESSING PICTURE DOES EMERGE, HOWEVER, OF THE POOR QUALITY OF BRITISH MANAGEMENT IN MANY LARGE FIRMS. THIS MAY SUGGEST THAT GOVERNMENT ATTEMPTS TO BECOME MORE INVOLVED IN INDUSTRIAL POLICY AND DECISION MAKING VIA SUCH VEHICLES AS THE NEW INDUSTRY BILL (SEE REF B) SHOULD NOT BE VIEWED AS "TOTALLY IRRELEVANT SOCIALIST NONSENSE."

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